

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

NOTICE OF PROPOSED ACTION

DATE: May 29, 2009

REGULATION FILE: REG-2007-00038

SUBJECT OF PROPOSED RULEMAKING

California Insurance Commissioner Steve Poizner (“Commissioner”) proposes to adopt the regulations, described below, after considering comments from the public. The Commissioner proposes to add Title 10, Chapter 5, Subchapter 3, Article 3.3, Sections 2309.1 through 2309.20, of the California Code of Regulations.

The proposed regulations are intended to improve the Commissioner’s surveillance of the financial condition of insurers by requiring (1) an annual audit by independent certified public accountants of the financial statements that report the financial position and the results of operations of insurers; (2) Communication of Internal Control Related Matters Noted in an Audit; (3) Management’s Report of Internal Control Over Financial Reporting.

PUBLIC HEARING - DATE AND LOCATION

Notice is hereby given that a public hearing will be held to permit all interested persons the opportunity to present statements or arguments, orally or in writing, with respect to the proposed regulations as follows

Date and Time	Wednesday, July 22, 2009 10:00 A.M.
Location	Department of Insurance 300 South Spring Street Los Angeles, CA 90013 1st Floor North Tower Administrative Hearing Bureau - Hearing Room

PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on July 22, 2009. Please direct all written comments to the following contact person:

Jack K. Hom
Senior Staff Counsel
California Department of Insurance
45 Fremont Street, 24th Floor
San Francisco, California 94105

(415) 538-4129
(415) 904-5896 (facsimile)
homj@insurance.ca.gov

Questions regarding procedure, comments, or the substance of the proposed regulations should be addressed to the contact person listed above. In the event that contact person is unavailable, inquiries regarding the proposed action may be directed to the backup contact person:

Tomoko Stock
Investment Officer II
California Department of Insurance
300 S. Spring Street, 14th Floor
Los Angeles, California 90013

(213) 346-6182
stockt@insurance.ca.gov

DEADLINE FOR WRITTEN COMMENTS

All written materials must be received by the Commissioner, addressed to the contact person at the address listed above, **no later than 5:00 p.m. on July 22, 2009**. Any written materials received after that time will not be considered.

COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE

Written comments transmitted by e-mail will be accepted only if they are sent to the following e-mail address: homj@insurance.ca.gov. The Commissioner will also accept written comments submitted by facsimile only if they are sent to the attention of the contact person at the following **facsimile number: (415) 904-5896**. Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. **Comments sent by e-mail or facsimile are subject to the 5:00 P.M., July 22, 2009 deadline.**

AUTHORITY AND REFERENCE

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 900.2, 730, *et seq.*; 923 ; 739 – 739.12 , inclusive; 988; 1065.1, *et seq.*; 900.8; 900.9; 903.5; 924; 925, *et seq.*, with reference also to the National Association of Insurance Commissioner’s (“NAIC”) The Commissioner proposes to adopt these regulations pursuant to the authority in section 900.2 of the California Insurance Code; *CalFarm Insurance Company v. Deukmejian* (1989) 48 Cal.3d 805; *20th Century Insurance Company v. Garamendi* (1994) 8 Cal.4th 216.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing law, Insurance Code section 900.2, provides that all insurers doing business in California must have an annual audit by an independent certified public accountant. It further provides that the form and content of the audit report must be in conformity with the Annual Audited Financial Reports instructions contained in the annual statement instructions as adopted from time to time by the National Association of Insurance Commissioners (“NAIC”).

Existing law further provides that the Commissioner may promulgate regulations to further the purposes of section 900.2.

There are no existing statutes or regulations that codify the form and content of the Annual Audited Financial Reports instructions.

The proposed regulations would codify the audit reports and related requirements currently contained in the NAIC’s Annual Statement Instructions and incorporates the standards

recently adopted by the NAIC. The proposed regulations would provide specific guidance on the contents of the Annual Audited Financial Reports and require that insurers register the name and address of their independent certified public accountant with the Commissioner.

The proposed regulations would also provide (1) the list of qualifications for independent certified public accountants to be eligible to conduct the audits; (2) the conditions under which insurers may consolidate or combine audit reports; (3) the scope of the audit report.

The proposed regulations would also provide that insurers and independent certified accountants have a duty to report adverse financial conditions and any unremediated material weaknesses to the Commissioner.

The proposed regulations would also provide definitions of the terms used in the regulations and also provide that Audit Committee members must be “independent” as that term is defined in the regulations.

Finally, the proposed regulations would also provide for exemptions and effective dates.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed regulations do not impose any mandates on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with section 17500) of Division 4 of the Government Code would require reimbursement.

COST OR SAVINGS TO ANY STATE OR LOCAL AGENCY OR SCHOOL DISTRICT OR IN FEDERAL FUNDING

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency and no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with section 17500) of Division 4 of the Government Code. There are no nondiscretionary costs or savings imposed on local agencies, and no cost or savings in federal funding to the State.

ECONOMIC IMPACT ON BUSINESSES AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that the adoption of the proposed regulations will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR ENTITIES/BUSINESSES

The Commissioner has determined the proposed regulations may have some cost impact on a representative private person in that an insurer may have to institute internal procedures to ensure it is in compliance with the corporate governance provisions of these proposed regulations.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The Commissioner is required to assess any impact the proposed regulations may have on the creation or elimination of jobs within the State of California; to assess the creation of new businesses or the elimination of existing businesses within the State of California; to assess the expansion of businesses currently doing business within the State of California.

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There may be a small increase in accounting firms retained or company staff allocated to help set up the necessary process to meet the regulations' requirements. The Commissioner also invites interested parties to comment on these issues.

FINDING OF NECESSITY

The Commissioner finds that it is necessary for the welfare of the people of the State that the proposed regulations apply to businesses.

IMPACT ON SMALL BUSINESS

The Commissioner has determined the proposed action may affect small business.

IMPACT ON HOUSING COSTS

The matters proposed herein will have no significant effect on housing costs.

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has been otherwise identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which the regulations are proposed or would be as effective as and less burdensome to affected private persons than the proposed regulations. The Commissioner invites public comment on alternatives to the regulations.

DEADLINE FOR WRITTEN COMMENTS

All written comments, whether submitted at the hearing or by U.S. Postal Service or any other delivery service, or by e-mail or facsimile, must be received by the Commissioner, c/o the contact person at the address listed above, **no later than 5:00 P.M. on July 22 2009.**

All persons are invited to submit statements, arguments, or contentions relating to the proposed regulations by submitting them in writing to the contact person **no later than 5:00 P.M. on July 22, 2009.** In the alternative, statements, arguments, or contentions may be presented orally at the public hearing.

ACCESS TO HEARING ROOMS

The facilities to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the contact person in order to make special arrangements, if necessary.

ADVOCACY OR WITNESS FEES

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of Title 10 of the CCR in connection with their participation in this matter. Interested persons should contact the Office of the Public Advisor at the following address to inquire about the appropriate procedures.

Office of the Public Advisor
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105

A copy of any written materials submitted to the Public Advisor regarding this rulemaking must also be submitted to the contact person for this hearing. Please contact the Office of the Public Advisor for additional information.

TEXT OF REGULATIONS AND INITIAL STATEMENT OF REASONS

The Commissioner has prepared an Initial Statement of Reasons ("ISOR") that sets forth the reasons for the proposed regulations. Upon request, the ISOR and the text of the proposed regulations will be made available for inspection and copying. Requests for the ISOR and the text of the proposed regulations should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the proposed regulations, the ISOR, and any supplemental information, is contained in the Rulemaking File: REG-2007-00038 and is available for inspection and copying by prior appointment at 45 Fremont Street, 23rd Floor, San Francisco, California 94105, between the hours of 9:00 A.M. and 4:30 P.M., Monday through Friday.

Final Statement of Reasons

After it has been prepared, and upon request, the Final Statement of Reasons ("FSOR") will be made available for inspection and copying. Requests for the FSOR should be directed to the contact person listed above.

AUTOMATIC MAILING

A copy of the proposed regulations and this Notice (including the Informative Digest, which contains the general substance of the proposed regulations) will be sent to all persons who have previously filed a request to receive notice of proposed rulemaking with the Commissioner.

WEBSITE POSTINGS

Documents concerning these proposed regulations are available on the CDI's website. To access them, go to <http://www.insurance.ca.gov>. Find at the right-hand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'PROPOSED REGULATIONS' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To browse, click on the 'Currently Proposed Regulations' link. A list of the names of regulations for which documents are posted will appear. Find in the list the link to 'Annual Financial Reporting' and click it. Links to the documents associated with these regulations will then be displayed.

To search, enter "REG-2007-00038" (the CDI's regulation file number for these regulations) in the search field. Alternatively, search by keyword ("financial reporting," for example, or "audit committee"). Then, click on the 'Submit' button to display links to the various filing documents.

MODIFIED LANGUAGE

If the Commissioner adopts regulations which differ from those which have originally been made available but are sufficiently related to the original proposed regulations, the amended regulations will be made available to the public for at least 15 days prior to the date of adoption of the amended regulations. Interested persons should request a copy of the amended regulations from the contact person listed above.

May 29, 2009